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ORIGINAL



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

FRANKBERGONZI

Plaintiff,

v.

RITE AID CORPORATION

Defendant.)

Civil Action No. 20453-NC

I

MEMORANDUM OPINION

Submitted: October 1, 2003

Decided: October 20, 2003

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10/20/03 3:46 pm  
Register in Chancery

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CHANDLER, Chancellor

Plaintiff Frank Bergonzi, former chief financial officer of defendant Rite Aid Corporation ("Rite Aid" or the "Company"), filed this action for advancement, pursuant to section 145(k) of the Delaware General Corporation Law, against Rite Aid on July 28, 2003. Defendant answered and filed a counterclaim seeking repayment of the amounts previously advanced to Bergonzi. Pending before this Court are the plaintiff's motions to expedite the instant proceedings and dismiss the counterclaim.

## I. BACKGROUND

Beginning in late 1999, Rite Aid and many of its officers and directors, including Bergonzi, became embroiled in numerous proceedings surrounding the company's accounting practices. These proceedings include a SEC investigation, a grand jury investigation, a derivative action in Delaware, and a civil suit in Pennsylvania. Bergonzi retained O'Melveny & Myers, LLP ("O'Melveny") and Price Waterhouse Coopers ("PWC") to represent him and sought to have Rite Aid advance him the expenses incurred in connection with defending the proceedings.

Article Tenth of Rite Aid's Restated Certificate of Incorporation sets forth the Company's indemnification obligations. Article Tenth, Section B, paragraph (1) provides:

The right to indemnification conferred by this Section B shall be a contract right and shall include the right to be paid by the

corporation the expenses incurred defending any such proceeding in advance of its final disposition; provided, however, that if the General Corporation Law requires, the payment of such expenses . . . shall be made only upon delivery to the corporation of an undertaking . . . to repay all amounts so advanced if it shall ultimately be determined that such director or officer is not entitled to be indemnified . . . .<sup>1</sup>

Paragraph (2) of Section B provides that if a claim under paragraph (1) is not paid within thirty days, the officer or director may bring suit against the corporation to recover the unpaid amount. Paragraph (2) also states:

It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending any proceeding in advance of its final disposition where the required undertaking, if any is required, has been tendered to the corporation) that the [officer or director] has not met the standards of conduct which make it permissible under the General Corporation Law for the corporation to indemnify the [officer or director] for the amount claimed . . . .<sup>2</sup>

The language "final disposition" and "ultimately be determined" found in Article Tenth mirror the language used in 10 Del. C. § 145(e).

Pursuant to Article Tenth Bergonzi was sent two "forms of undertaking" by Rite Aid's general counsel that he was required to sign "as a condition to advancing expenses."<sup>3</sup> The first form, entitled "UNDERTAKING FOR ADVANCEMENT OF EXPENSES" bound

<sup>1</sup> Article Tenth § B, ¶ (1).

<sup>2</sup> Article Tenth, § B, ¶ (2). Paragraph (2) further states that "an actual determination by the corporation . . . that the [officer or director] has not met such applicable standard of conduct" shall not "be a defense to the action." *Id.*

<sup>3</sup> Def.'s Reply Br., Ex. A.

Bergonzi to repay monies advanced Wit shall ultimately be determined that I am not entitled to be indemnified by the Corporation as authorized by section 145."<sup>4</sup> The second form, resembling a cover letter, bound Bergonzi to repay amounts advanced "in the event that a court of competent jurisdiction ultimately determines in a final judgment that I am not entitled to indemnification."<sup>5</sup> Following Bergonzi's execution of both forms, the Company proceeded to advance him money to aid in his defense.

On June 21, 2002, a federal grand jury indicted Bergonzi and others, accusing them of having engaged in a criminal conspiracy to defraud Rite Aid. The indictment alleged the deliberate filing of false financial statements and the creation of fraudulent employment agreements that purported to obligate the Company to pay certain employees, including Bergonzi, millions of dollars upon termination of their employment with the Company. On June 5, 2003, Bergonzi pled guilty before the United States District Court for the Western District of Pennsylvania to the lead count of the indictment, participation in a criminal conspiracy to defraud Rite Aid while serving as its chief financial officer. In his guilty plea colloquy,

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<sup>4</sup> 10 Del. C. § 145(a) only allows indemnification "if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful."

<sup>5</sup> Compl., Ex. C. Rite Aid argues that the second form, the cover letter, was a unilateral modification of the undertaking, but it appears from the record that the letter was prepared by Rite Aid and that Rite Aid requested Bergonzi execute the letter.

**Bergonzi** admitted under oath to deliberate falsification of the Company's financial statements and receiving a fraudulently back-dated employment agreement purporting to grant him millions of dollars. The court accepted **Bergonzi's** guilty plea as knowingly and voluntarily made.

Following **Bergonzi's** guilty plea, Rite Aid's Board of Directors decided that **Bergonzi** was not entitled to indemnification, notified **Bergonzi** that it would no longer advance the costs of his defense, and demanded repayment (pursuant to the undertaking) of money the Company had previously advanced on his behalf. Later, **Bergonzi** filed this action for advancement.

## II. ANALYSIS

### A. Motion to Dismiss Rite Aid's Counterclaim

Rite Aid's counterclaim asserts that **Bergonzi's** guilty plea terminated any right he had to advancement or indemnification under the Company's Certificate of Incorporation, the undertakings signed by **Bergonzi**, and 10 Del. C. § 145. **Bergonzi** argues that the counterclaim is not ripe because an ultimate determination of his right to advancement has yet to occur and, in fact, cannot occur before a final disposition of the proceedings.

Article Tenth of Rite Aid's charter provides **Bergonzi** with the contract right to advancement before a final disposition of the criminal

proceedings. Bergonzi has pled guilty, but he still must testify in a related proceeding pursuant to his plea agreement. Bergonzi's use as a witness will impact whether the government gives him a favorable sentencing recommendation. It appears, as a practical matter, that the proceedings have not reached their final disposition. Indeed, there is Delaware Supreme Court and United States Supreme Court authority that the entry of a guilty plea, before sentencing, is not a final disposition.<sup>6</sup>

As Bergonzi is entitled to advancement until a final disposition of the proceedings, and as the proceedings have not yet reached a final disposition, Bergonzi has a presently enforceable right to advancement. Advancement is a right that the Supreme Court has recognized as distinct from the right to indemnification.<sup>7</sup> In *Citadel Holding Corp. v. Roven*, a company and former director executed an agreement that closely tracks the language of the undertaking signed by Bergonzi.<sup>8</sup> The Supreme Court held that the former director was entitled to advancement of expenses to defend against a lawsuit brought by the company itself.<sup>9</sup> The Supreme Court found that the "ultimate determination" that the former director was not entitled to indemnification only conditioned "the breadth of the written promise" the former director

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<sup>6</sup> *Berman v. U.S.*, 302 U.S. 211 (1937); *Weaver v. State*, 779 A.2d 254 (Del. 2001).

<sup>7</sup> *Citadel Holding Corp. v. Roven*, 603 A.2d 818 (Del. 1992).

<sup>8</sup> *Id.* at 822.

<sup>9</sup> *Id.*

was required to make to secure the advancement of litigation expenses (*i.e.*, he was required to repay the money *if* he was not entitled to indemnification) and did not limit the former director's right to those advances initially.<sup>10</sup>

Rite Aid attempts to avoid *Citadel* by arguing that Bergonzi's guilty plea presents a unique circumstance and should constitute an "ultimate determination" that Bergonzi is not entitled to indemnification—triggering the obligation to repay the advanced expenses (and cutting off the right to future advancements). Rite Aid's argument that the guilty plea constitutes an ultimate determination of Bergonzi's right to advancement must fail, however, under the plain terms of the undertaking drafted by Rite Aid and signed by Bergonzi.

Rite Aid provided Bergonzi with an undertaking that bound him to repay amounts advanced "in the event that a court of competent jurisdiction ultimately determines in a final judgment that I am not entitled to indemnification."<sup>11</sup> The terms of the undertaking require three essential predicates before an ultimate determination of Bergonzi's right to

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<sup>10</sup> *Id.* See also *Advanced Mining Sys., Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch. 1992) ("indemnification rights and rights to advancement of possibly indemnifiable expenses [are] quite different types of legal rights"); *Ridder v. Cityfed Fin. Corp.*, 47 F.3d 85, 87 (3d Cir. 1995) ("Under Delaware law, appellants' right to receive the costs of defense in advance does not depend upon the merits of the claims asserted against them, and is separate and distinct from any right of indemnification").

<sup>11</sup> Compl., Ex. C. Rite Aid argues that the second form, the cover letter, was a unilateral modification of the undertaking, but it appears from the record that the letter was prepared by Rite Aid and that Rite Aid requested Bergonzi execute the letter.

indemnification. First, a court must make the requisite determination of entitlement to indemnification. Second, a court must have competent jurisdiction to determine whether Bergonzi is entitled to indemnification. And third, the determination must take the form of a final judgment. Bergonzi's guilty plea does not satisfy these conditions. After Bergonzi pled guilty, the Middle District of Pennsylvania made no findings regarding Bergonzi's entitlement to indemnification under Delaware law. The court merely accepted Bergonzi's plea. Moreover, that proceeding has not reached final judgment since Bergonzi still awaits sentencing.<sup>12</sup> Again, Rite Aid could have (and perhaps should have) drafted this provision differently, but simply did not.

Regardless of whether the guilty plea is actually an ultimate determination of Bergonzi's right to indemnification, Rite Aid's Article Tenth forbids this inquiry in the instant proceeding. Article Tenth states;

*It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending any proceeding in advance of its final disposition where the required undertaking, if any is required, has been tendered to the corporation) that the [officer or director] has not met the standards of conduct which make it permissible under the General Corporation Law for the corporation to indemnify the [officer or director] for the amount claimed . . . .*<sup>13</sup>

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<sup>12</sup> See *supra* n.6 and accompanying text.

<sup>13</sup> Article Tenth, § B, ¶ (2) (emphasis added).



Bergonzi is bringing an action to enforce a claim for advancement of expenses under section 145(k) (as contemplated by Article Tenth) and, as noted above, the criminal proceeding has not reached its final disposition. Read in context, the plain language of Rite Aid's charter bars a counterclaim that asserts, in an advancement proceeding, that Bergonzi has not met the standards of conduct that make indemnification permissible under Delaware law.<sup>14</sup> Rite Aid may not unilaterally rescind its agreement not to assert a conduct defense in an advancement proceeding.<sup>15</sup> Rite Aid could have easily drafted this provision differently, but it did not and must now maintain its bargain with its former officer.

For these reasons, Rite Aid's counterclaim is dismissed as not ripe for adjudication. The controversy regarding Bergonzi's right to indemnification "has not yet matured to a point where judicial action is appropriate."<sup>16</sup> The dismissal is without prejudice to assertion of the counterclaim at a later date and, of course, does not speak to whether Bergonzi is entitled to indemnification.

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<sup>14</sup> Rules of contract construction apply to corporate charters. *Hibbert v. Hollywood Park, Inc.* 457 A.2d 339, 342-43 (Del. 1983). Moreover, ambiguity in the corporate certificate is construed against the corporation. *Kaiser Alum. Corp. v. Matheson*, 581 A.2d 392, 398-99 (Del. 1996).

<sup>15</sup> See *Salaman v. Nat'l Media Corp.*, 1992 WL 808095, at \*2 (Del. Super. Oct. 8, 1992) (corporation may not unilaterally rescind agreement to advance expenses).

<sup>16</sup> *Stroud v. Milliken Enters., Inc.*, 552 A.2d 476, 480 (Del. 1989).

*B. Motion for Expedited Proceedings*

Section 145(k), enacted in 1994, allows the Court of Chancery to “summarily determine a corporation’s obligation to advance expenses (including attorneys’ fees).”<sup>17</sup> The adoption of section 145(k) “reflects a policy determination by the General Assembly that the Court of Chancery should be receptive to and accord expedited treatment to claims for advancement of expenses raised by putative corporate indemnitees.”<sup>18</sup> Rite Aid has presented no facts or law that would call this policy into question. Therefore, Bergonzi’s motion for expedited proceedings is granted. Counsel, should confer regarding a schedule that will bring this matter to a prompt final hearing.

IT IS SO ORDERED.

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<sup>17</sup> 8 Del. C. § 145(k).

<sup>18</sup> *Fuisz v. Biovail Techs., Ltd.*, 2000 Del. LEXIS 121, \*9 (Del. Ch.).